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CHANGE AT RBI - INSTITUTIONS AND INDIVIDUALS

The early exit of RBI's Dy. Governor Dr. Viral Acharya is not surprising. Though it was a rumor, but market had anticipated it after the resignation of former Governor Dr. Urjit Patel way back in December 2018. Dr. Acharya was appointed as the RBI Dy. Governor on January 23, 2017 for a 3-year term. However, citing unavoidable personal circumstances, Dr. Acharya is leaving RBI on 23rd July 2019, 6 months prior to the completion of his term.

Quite expectedly, a few voices of concern are being raised here & there about the DG's pre-mature exit, just like it was done when Governor Rajan had left the RBI. On that occasion, a noted journalist, had quipped that "*If Rajan is asked to leave, India will suffer a mass exodus of foreign portfolio investment*." Many economists had said that markets will not respond well to the news.

However, the data says otherwise. Capital flows, in fact, nearly doubled in H1 FY18 compared to H1 FY17. Forex reserves also grew, rupee appreciated and stock market also gained post one-year of Rajan's exit announcement. The news of Dr. Viral Acharya's exit too, although unfortunate, will not roil the markets. Institutions are human creations that decide the rules of the game, they strive to create a Nash Equilibrium, minimizing the incentive for unilateral deviations.

We believe, institutions are more important than individuals and ultimately what is important is the credibility and the independence of any institution and nothing else. Over the years, RBI, as an institution, has been extremely visionary, pragmatic and fairly independent throughout! In fact, an analysis of RBI's history, in respect of managing price stability in the country since 1983, points out that almost all the Governors have given prime importance to price stability, with the number of positive surprises in inflation numbers were also significantly high in earlier decades compared to current scenario.

DR VIRAL ACHARYA TO LEAVE RBI EARLY

- The exit of RBI's Dy. Governor Dr. Viral Acharya is not surprising. Though it was a rumor, but market had anticipated it after the resignation of former Governor Dr. Urjit Patel way back in December 2018. Dr. Acharya was appointed as the RBI Dy. Governor on January 23, 2017 for a 3-year term. However, citing unavoidable personal circumstances, he has decided to leave RBI on 23rd July 2019, 6 months before his term ends.
- The New York University professor, who became the youngest to become a Deputy Governor, has been a strong advocate of conservatism when it came to either monetary policy or dealing with financial markets. DG had earlier raised concern over the importance of RBI's independence in October 2018.
- At RBI he held a total of 9 portfolios including, Corporate Strategy and Budget Department, Financial Stability Unit, Department of Economic Policy & Research and Monetary Policy Department incl. Forecasting & Modeling Unit among others.
- Dr Acharya has been part of the past 15 MPC meetings. He and the other external MPC members have been on the same page on majority of occasions. However, there is more diversion in the decision of the DG and the Executive Director, particularly visible in the recent monetary policy decisions.
- So we believe that the next MPC meeting in August to be held after the exit of Viral, is likely to see more nuanced discussion veered towards more dovish stance going forward and consequently, space opening up for more cuts.

Repo Rate Decision of Dr. Viral V. Acharya

FY	Monetray Policy	Decision
2016-17	6th	Unchanged
2017-18	1st	Unchanged
	2nd	Unchanged
	3rd	Decrease by 25 bps
	4th	Unchanged
	5th	Unchanged
	6th	Unchanged
2018-19	1st	Unchanged
	2nd	Increase by 25 bps
	3rd	Increase by 25 bps
	4th	Unchanged
	5th	Unchanged
	6th	Unchanged
2019-20	1st	Unchanged
	2nd	Decrease by 25 bps

Source: RBI, SBI Research, Yellow indicates the instances of MPC decision being different from that of DG

Decision of MPC members

	External/Internal interface			RBI interface
Members of MPC	DG & Dr. Chetan Ghate	DG & Dr. Pami Dua	DG, Dr. Pami Dua & Dr.	DG & ED
# of times same decision	14	13	12	11

Source: RBI, SBI Research

DATA SHOWS NO REASON FOR PANIC

- Quite expectedly, a few voices of concern are again being raised about the DG's premature exit, just like it was done when Governor Rajan had left, although he left only after completing his term.
- At that time, a noted journalist, had written that "If *Rajan is asked to leave, India will suffer a mass exodus of foreign portfolio investment*." He had also added: "*Tens of billions of dollars will flow out, maybe as much as 100 billion (if this coincides with some other bad news like a further Chinese slowdown or British exit from the European Union). The stock markets will crash and the currency markets will panic. India will be bruised severely. Those wanting Rajan's exit need to understand the consequences of what they wish for*."
- However, the data points otherwise. Capital flows in fact nearly doubled in H1 FY18 compared to H1 FY17. Forex reserves also grew, rupee appreciated and stock market also gained post one-year of Rajan's exit announcement.
- The news of Dr. Viral Acharya's exit too, although unfortunate, will not roil the markets.

PRICE STABILITY AND ANCHORS

- The preamble to the Reserve Bank of India Act, 1934 sets out the objectives as "to regulate the issue of Bank notes and the keeping of reserves with a view to **securing monetary stability in India** and generally to operate the currency and credit system of the country to its advantage". Although there was no explicit mandate for price stability (pre-Rajan), the objectives of monetary policy in India have evolved as those of maintaining price stability and ensuring adequate flow of credit to the productive sectors of the economy. In essence, monetary policy over the years have tried to maintain a judicious balance between price stability and economic growth.
- An analysis of RBI's history, in respect of managing price stability in the country since 1983, points out that almost all the Governors have given prime importance to price stability. In fact, counter intuitively, the number of positive surprises in inflation numbers were also significantly high in earlier decades compared to current scenario (interestingly, the number of net positive surprises were positive during Dr Bimal Jalan and Dr D. Subba Rao tenure, but turned negative in recent times, as RBI moved on to target CPI from WPI earlier). RBI thus has always been an enemy of inflation, and it is incorrect to say that this assumed primacy only in recent times.
- Interestingly, when the inflation targeting comes up for review on 2021, we propose that the inflation band be made reasonable and revised upwards to around 5%, consistent with the average numbers during the last 5 years!

Macro-Economic Indicators since Rajan's Exit

Indicator	Unit	Rajan's exit announcement (Jun'16)	After 1 year (Jun'17)
Rs/$ Exchange Rate	-	67.29	64.45
Foreign Exchange Reserves	$ Bn	362.8	382.7
Import Cover	Months	11.8	10.4
FII	$ Bn	7.9 (H1 FY17)	14.7 (H1 FY18)
Current Account Deficit	% of GDP	0.1 (Q1 FY17)	2.5 (Q1 FY18)
CPI-Combined	%	5.77	1.46
BSE Sensex	-	26718	31145

Source: SBI Research

Nominal Anchors

	Weights	Jan'14 to May'19		Apr'16 to May'19	
		Mean	SD	Mean	SD
Overall CPI	100.00	**4.6**	1.6	**3.8**	1.2
Core CPI	47.3	**5.2**	1.1	**5.1**	0.6
Core of core	38.71	5.7	0.9	5.4	0.6
CPI Ex Veg	93.96	**4.9**	1.3	**4.1**	0.8

Source: SBI Research

RBI is synonymous with Price Stability

Governor	From	To	Average Inflation (WPI)	Negative Surprises (Inflation >Average + 1 SD)	Positive Surprises (Inflation < Average - 1 SD)	Net Surprises
Manmohan Singh	16-Sep-82	14-Jan-85	7.1	3	3	0
R. N. Malhotra	4-Feb-85	22-Dec-90	7.0	14	11	-3
S. Venkitaramanan	22-Dec-90	21-Dec-92	12.6	3	5	2
C. Rangarajan	22-Dec-92	21-Nov-97	7.8	10	11	1
Bimal Jalan	22-Nov-97	6-Sep-03	4.7	8	13	5
Y. V. Reddy	6-Sep-03	5-Sep-08	6.1	7	7	0
D. Subbarao	5-Sep-08	4-Sep-13	7.1	4	9	5
Raghuram Rajan	4-Sep-13	4-Sep-16	CPI: 6.4	5	3	-2
Dr. Urjit R. Patel	4-Sep-16	11-Dec-18	CPI: 3.8	5	8	3

Source: SBI Research

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